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CC Docket No. 95-116

AT&T CORP. COMMENTS

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SUMMARY

In order to carry its burden of proof, an ILEC that proposes to tariff local number portability ("LNP") surcharges or query charges must demonstrate that its treatment of joint and common LNP costs comports with the straightforward principles established in the Cost Recovery Order. Those requirements reduce to two questions, both of which must be answered in the affirmative:

First, has an incremental investment been made or a new expense been legitimately incurred because of an ILEC's obligation to implement LNP? In other words, would an expenditure have occurred "but, for" number portability? If not, then the ILEC simply has not incurred a cost directly related to its implementation of LNP. The Commission's orders make clear that ILECs may not seek to shift recovery for either embedded costs (i.e., costs incurred prior to LNP implementation) or general network upgrades to consumers or competing carriers via LNP surcharges or query charges.

Second, assuming the ILEC has in fact incurred an incremental and legitimate cost directly related to providing LNP, does the investment or expense support services or functionalities other than number portability? If so, then the Cost Recovery Order makes plain that it is improper to allocate its entire cost to LNP, even if the investment were made in order to support that service.

Finally, the Commission should use this proceeding and its ongoing LNP query tariff investigation to clarify that LNP-related tariffs may not impose bloated charges that purportedly represent "overhead," "joint and common costs" or other costs. Such charges represent the largest single factor in the LNP query tariffs filed to date; in some cases more than doubling an ILECs' alleged costs. While an ILEC may properly recover some reasonable level

of overhead costs that are actually caused by LNP, the Cost Recovery Order expressly prohibits it from attempting to spread the general overhead costs of its overall operations to portability surcharges or query charges. Moreover, many of the ILEC LNP query tariffs filed to date have attempted to charge for "joint and common costs" or other "costs" in addition to overhead. Such markups are patently improper, and appear to represent pure profit.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)
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Telephone Number Portability)
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_____)

CC Docket No. 95-116

AT&T CORP. COMMENTS

Pursuant to the Commission's recent Cost Recovery Order¹ in the above-captioned docket, AT&T Corp. ("AT&T") hereby submits these comments concerning ILECs' recovery of "joint costs" -- that is, costs that must be apportioned between local number portability ("LNP")-related services and other services.

I. ILECS BEAR THE BURDEN OF PROOF THAT LNP SURCHARGES AND QUERY CHARGES RECOVER ONLY COSTS DIRECTLY RELATED TO LNP

The Commission's prior LNP orders provide straightforward principles for allocating joint costs, as well as a clear framework in which to analyze them. The Cost Recovery Order permits, but does not require, ILECs to recover their costs that are "directly related to providing long-term number portability" via a federally tariffed end user surcharge, and also permits ILECs to recover their direct costs of providing LNP query

¹ Third Report and Order, Telephone Number Portability, CC Docket No. 95-116, FCC 98-82 (released May 12, 1998), ¶ 75 ("Cost Recovery Order").

services through federally tariffed charges.² The Cost Recovery Order correctly determined that § 251(e) requires that LNP query charges and end user surcharges be cost-based. The ILECs that have participated in the LNP query tariff investigations to date have argued repeatedly -- despite the Cost Recovery Order's holding to the contrary -- that the market for query services should be deemed fully competitive, and that they should be free to charge rates that openly violate the cost-based standards established in that order. The Commission correctly has held, however, that § 251(e) authorizes ILECs only to recover their LNP costs, not to extract monopoly rents by exploiting their market power over local exchange services or to shift the costs of other services to purported "LNP charges."

The requirement that ILEC's tariff cost-based LNP surcharges and query charges squarely places the burden of justifying those charges on the ILECs themselves. Section 204 of the Communications Act and the Commission's precedents unequivocally establish that the ILECs must provide sufficient information to prove that the rates they propose are "just and reasonable," and otherwise comport with the LNP cost recovery requirements.³ Despite this allocation of the burden of proof, the ILECs' LNP query tariff filings to date have been woefully inadequate, as the Commission recognized in its order

² Id., ¶ 9.

³ See AT&T, Opposition to Direct Cases, filed July 10, 1998, pp. 3-9, in Number Portability Query Services, CC Docket No. 98-14 ("AT&T Opposition to Direct Cases"). AT&T's opposition to the ILECs' direct cases in support of their most recent LNP query tariffs discusses many issues that are directly pertinent to the instant proceeding. Accordingly, AT&T hereby incorporates its July 10, 1998 Opposition to Direct Cases into this pleading by reference.

terminating the first query tariff investigation.⁴ In the instant proceeding, it is crucial that the ILECs be required to come forward with more than just conclusory assertions that certain costs should be allocated to LNP. Bare claims that network upgrades were directly related to portability are not sufficient. The ILECs must provide detailed information about the joint costs they contend should be allocated to LNP, if any, and the methods and models they used to derive those costs, so that the Commission and other parties can evaluate them.

II. COSTS DIRECTLY RELATED TO PROVIDING LNP INCLUDE ONLY INCREMENTAL EXPENSES NOT ATTRIBUTABLE TO OTHER SERVICES

The Commission's orders establish three categories of LNP costs: (1) costs incurred by the industry as a whole, also known as "Type 1 costs"; (2) carrier-specific costs directly related to providing number portability ("Type 2 costs"); and (3) carrier-specific costs not directly related to providing number portability ("Type 3 costs"). The Cost Recovery Order permits carriers to recover only their Type 1 and Type 2 costs, and the key issue before the Commission both in this proceeding and in the LNP query tariff investigations is to expand upon the principles announced in that order so as to more precisely define the contours of Type 2 -- that is, to determine what costs will be deemed "directly related to providing number portability."⁵

⁴ See Tariff Investigation and Termination Order, Number Portability Query Services, CC Docket No. 98-14 (released March 30, 1998), ¶ 14 ("Rather than provide the Commission and interested parties with sufficient data to evaluate the components and reasonableness of their charges, the carriers provided conclusory rates and brief narratives describing their methodologies.").

⁵ Shared LNP costs are deemed to be Type 2 costs after they are allocated to a particular carrier. Cost Recovery Order, ¶ 69. Defining and recovering Type 1 costs should prove uncontroversial, with one important caveat. Some of the ILEC

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The Cost Recovery Order delineates clear principles for determining recoverable LNP costs:

We conclude that carrier-specific costs directly related to providing number portability are limited to costs carriers incur specifically in the provision of number portability services, such as for the querying of calls and the porting of telephone numbers from one carrier to another. Costs that carriers incur as an incidental consequence of number portability, however, are not costs directly related to providing number portability.⁶

The above definition and other guidance in the order suggest that if an investment or expense is to be deemed a recoverable cost of LNP, two questions must be answered in the affirmative.

First, has an incremental investment been made or a new expense been legitimately incurred because of an ILEC's obligation to implement LNP? If not, then the ILEC has not incurred a cost due to LNP implementation. The Commission's orders make clear that ILECs may not seek to shift recovery for embedded costs (i.e., costs incurred prior to LNP implementation) or general network upgrades to consumers or competing carriers via LNP surcharges or query charges.

Second, assuming the ILEC has in fact incurred an incremental and legitimate cost directly related to providing LNP, does the investment or expense support services or functionalities other than number portability? If so, then it is plainly improper to

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LNP query tariff filings to date have not broken out Type 1 costs from their other cost calculations, and it is thus impossible for the Commission or commenters to verify the accuracy of their assumptions.

⁶ Cost Recovery Order, ¶ 72.

allocate its entire cost to LNP, even if the investment were made in order to support that service.

A. Recoverable "Type 2" Costs Must Be Incremental Expenses.

The first phase of the Commission's inquiry should essentially be a "but, for" test -- an expense or investment is not recoverable unless it would not have been incurred but for LNP implementation. In making this analysis the Commission should scrutinize claimed expenses closely, as ILECs have strong incentives to improperly characterize investments as LNP costs, in order to boost portability surcharges and query rates, and thereby also subsidize competitive services. For example, ILECs have been incurring costs, such as for OSS, in order to resell their local services to other carriers or provision unbundled network elements. Costs such as these plainly are not related to number portability, and should not be recovered via LNP tariffs.

Under this test, investments that an ILEC made prior to LNP implementation -- for example, existing signaling networks and other systems -- cannot be considered as direct costs incurred to provide number portability. The First LNP Order correctly held that ILECs could recover only their incremental costs of implementing interim LNP methods, and the Commission has consistently hewed to this same reasoning.⁷ Despite this guidance, the most recent LNP query tariffs sought to recover for significant embedded investment.

⁷ See, e.g., First Report and Order & Further Notice of Proposed Rulemaking, Telephone Number Portability, 11 FCC Rcd. 8352, 8418 (1996) ("The costs of currently available number portability are the incremental costs incurred by a LEC to transfer numbers initially and subsequently forward calls to new service providers using existing RCF, DID, or other comparable measures.").

For example, one-third of the total investment claimed by Bell Atlantic was for the use of embedded investments such as existing SS7 systems.⁸ That BOC did not even attempt to demonstrate, however, that using its existing assets to provide LNP in any way increased its costs. Plainly, there can be no "cost directly related to providing LNP" if there is no new cost incurred. An ILEC's use of embedded facilities cannot give rise to Type 2 costs except to the extent that the ILEC can show that the use of those assets for LNP in fact gives rise to new costs.

Further, permitting ILECs to claim embedded investments as Type 2 costs would grant them a double recovery. Contrary to the assertions of some ILECs, such a standard would not permit LNP users to get a "free ride" on existing assets. The fact of the matter is that if no new costs arise due to LNP, then no additional charges can possibly be warranted in light of the fact that all existing costs are already being recovered in other rates and tariffs. The cost of ILECs' existing signaling and other systems already is fully recovered via their charges for other services. The Commission's order designating the most recent query charges for investigation expressly recognized the risk of double recovery if embedded investments were included in LNP tariffs:

Bell Atlantic provides many worksheets, but has not explained them or shown that its calculations include only the costs of providing portability services. In particular, they include substantial amounts of "embedded network investment," the costs of which may be already recovered in other rates.⁹

⁸ See Bell Atlantic Tariff F.C.C. No. 1, Transmittal No. 1036, filed March 23, 1998, Workpaper 6-6 pp. 1-2; AT&T Opposition to Direct Cases, pp. 12-15.

⁹ Order Designating Issues For Investigation, Number Portability Query Services, CC Docket No. 98-14 (released June 17, 1998), ¶ 8 ("Designation Order").

As an additional component of its inquiry into whether an expense would not have been incurred but for LNP, the Commission should ensure that ILEC expenditures in fact represent expenses or investments directly caused by LNP, rather than general upgrades that happened to coincide with implementation of that capability. Many new investments should not be attributed to LNP at all, but should be treated as general upgrades made by an ILEC in order to compete with CLEC entrants into its local monopoly territory, or simply to improve the performance of its network. The need for such scrutiny is heightened by the fact that the LNP Reconsideration Order permitted ILECs to limit their LNP implementation to switches for which they received a specific request for that service from a potential competitor.¹⁰ This approach permits ILECs "to focus their resources where competitors plan to enter,"¹¹ by requiring CLECs to provide advance notice of the areas they intended to target for local market entry. Armed with the knowledge that local competition was coming to a given area, an ILEC could be expected to upgrade its signaling and other systems in those areas (for example, to enable it to provide new services or lower its costs), whether or not those upgrades were also utilized for LNP.¹²

¹⁰ First Memorandum Opinion and Order on Reconsideration, Telephone Number Portability, 12 FCC Rcd. 7236, 7272-7277 (1997).

¹¹ Cost Recovery Order, ¶ 20.

¹² In addition, although the ILECs' refusal to comply with the market opening requirements of the 1996 Act has to date prevented CLECs from making more than de minimis entry into local markets, the ILECs nevertheless make billions of dollars worth of investments annually in an effort to improve the efficiency of their networks or to offer new services. Many network upgrades would have occurred

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B. Investments Made In Order To Support LNP Must Be Allocated To All Of The Services That Utilize Those Investments.

The "but, for" test described above is not the end of the inquiry, as the Commission's Cost Recovery Order makes clear. Even if a new investment were made in response to LNP implementation, an ILEC may not automatically allocate the entire incremental cost of that investment to number portability surcharges or query charges. Systems that were installed or upgraded as a direct result of number portability will in many cases also be used to support other services.

The division between carrier-specific costs directly related to providing number portability and carrier-specific costs not directly related to providing number portability recognizes that some component of the costs carriers incur will provide carriers with benefits unrelated to number portability.¹³

An investment that is properly treated as a direct cost of LNP may also be used to provide other services, as the Cost Recovery Order expressly found. "[S]ome upgrades will enhance carriers' services generally, and that at least some portion of such upgrade costs are not directly related to providing number portability."¹⁴ Accordingly, the Commission required ILECs to properly apportion the costs of upgrades to LNP, rather than simply attributing their entire costs to number portability.

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without regard to LNP implementation, although ILECs have powerful incentives to shift the costs of such general upgrades to number portability.

¹³ Cost Recovery Order, ¶ 68.

¹⁴ Id., ¶ 73.

We reject the requests of some commenters that we classify the entire cost of an upgrade as a carrier-specific cost directly related to providing number portability just because some aspect of the upgrade relates to the provision of number portability. Carriers incur costs for software generics, switch hardware, and OSS, SS7 or AIN upgrades to provide a wide range of services and features. Consequently, only a portion of such joint costs are carrier-specific costs directly related to providing number portability.¹⁵

III. ILECS MAY NOT ATTEMPT TO RECOVER ADDITIONAL PROFIT IN THE GUISE OF GENERAL OVERHEAD OR OTHER PURPORTED "COMMON COST" FACTORS

The largest single factor in the purported portability costs claimed in the ILEC query service tariffs filed to date is overhead. Indeed, the overheads claimed in these filings have been shockingly bloated -- U S West's query tariff, to take one example, proposes an overhead loading factor of 2.41 -- i.e., two hundred and forty-one percent. Indeed, the ILEC query tariff filings to date have openly sought to recover profit and contribution in the guise of "overhead" or "joint and common costs."

The Cost Recovery Order unequivocally held that "Because carrier-specific costs directly related to providing number portability only include costs carriers incur specifically in the provision of number portability, carriers may not use general overhead loading factors in calculating such costs."¹⁶ To the extent claimed "overhead" costs represent actual, incremental LNP-related expenditures, ILECs properly may include an overhead factor in their calculations of their LNP costs.

¹⁵ Id.

¹⁶ Cost Recovery Order, ¶ 74 (emphasis added).

Southwestern Bell's ("SWBT") recent query tariff offers a generally reasonable description of "overhead" (although its tariff does not follow the methodology it describes):

SWBT incurs a great many costs that it would not be reasonable to direct to a particular service because to do so would require an expensive, detailed record system that would increase SWBT's costs as a company and for individual services.¹⁷

Under this conception, "overhead" represents costs that cannot reasonably be itemized and recorded, and companies routinely allow for such an accounting device. The Cost Recovery Order clearly establishes, however, that an ILEC may not seek to recover for charges other than those caused by LNP. Accordingly, while an ILEC may properly recover for some reasonable level of overhead costs that are actually caused by LNP, the Cost Recovery Order expressly prohibits it from attempting to spread the general overhead costs of its overall operations to portability surcharges or query charges.¹⁸

An ILEC's general overhead -- whether referred to by that name or by some other label -- is not directly caused by number portability, and to recover such costs via LNP charges would lead to double-recovery, as the Cost Recovery Order recognized:

Carriers already allocate general overhead costs to their rates for other services, and allowing general overhead loading factors for long-term number portability might lead to double recovery. Instead, carriers may identify as carrier-specific costs directly related to providing long-term number portability only those incremental

¹⁷ Southwestern Bell Telephone Company, Tariff F.C.C. No. 73, Transmittal No. 2694, filed March 4, 1998, D&J p. 13.

¹⁸ See generally AT&T Opposition to Direct Cases, pp. 9-12.

overheads that they can demonstrate they incurred specifically in the provision of long-term number portability.¹⁹

"General overhead" expenses are pre-existing, fixed costs that already are incorporated in an ILECs current rates. Such costs represent items such as a proverbial "piece of the CEO's desk," or a corporate jet.²⁰ These types of expenses plainly are not costs caused by -- or in any respect increased by -- number portability. The ILECs that have filed LNP query tariffs to date have argued at length that they should be permitted to increase their query charges by bloated factors that purportedly spread some part of their overall corporate overhead across those services. However, none of these ILECs has demonstrated -- or can demonstrate -- that LNP has caused these overhead costs to increase.²¹ As the Commission

¹⁹ Cost Recovery Order, ¶ 74 (emphasis added).

²⁰ Indeed, in an order issued earlier this summer, the Indiana Utility Regulatory Commission found that Ameritech improperly included items such as a golf tournament sponsorship and tickets for skyboxes at sporting events in the "shared and common costs" that it sought to allocate to unbundled network elements. In The Matter Of Commission Investigation And Generic Proceeding On Ameritech's Indiana's Rates For Interconnection, Service, Unbundled Elements, And Transport And Termination Under The Telecommunications Act Of 1996 And Related Indiana Statutes, Cause No. 40611, June 30, 1998, p. 28.

²¹ SWBT has argued that it should be permitted to add general overhead to its LNP query rates because it purportedly is currently under-recovering those costs because competition has forced it to lower some of its prices. See Consolidated Response Of Southwestern Bell Telephone Company And Pacific Bell To Order Designating Issues For Investigation, filed July 1, 1998, pp. 7-8, in Number Portability Query Services, CC Docket No. 98-14. In addition to being contrary to the Cost Recovery Order and utterly unsupported, this argument rests on the untenable presumption that SWBT can use LNP-related charges in order to guarantee itself a consistent revenue stream. Further, even if competition were reducing SWBT's profits (despite that BOC's record earnings in recent years), the Commission has held unequivocally that § 251(e) requires LNP charges to be cost-based.

has correctly held, ILECs may only recover their costs directly related to implementing LNP. Recovery of "general overhead" would do nothing more than add to ILECs' bottom line, as it bears no relation to the actual costs of implementing LNP.

Moreover, many of the ILEC LNP query tariffs filed to date have attempted to charge for "joint and common costs" or other "costs" in addition to overhead -- markups which appear to represent pure profit. For example, Bell Atlantic's most recent query tariff states that the difference between its costs to provide tandem queries and its rate for that service is 31%, while the difference between its end office query costs and that rate is 54%.²² In response to the Designation Order's requirement that it explain these figures, Bell Atlantic states that they "are simply rate-to-cost ratios which show by how much each rate exceeds the direct cost of providing the service."²³ However, prior to taking these markups, Bell Atlantic calculated a purported unit cost for queries that included an overhead factor. Thus, Bell Atlantic's markups appear to represent pure profit, and it has offered no other explanation for them.

²² See Designation Order, ¶ 9.

²³ Direct Case of Bell Atlantic, filed July 1, 1998, p. 4, in Number Portability Query Services, CC Docket No. 98-14.

CONCLUSION

The Commission should require that any ILEC tariffing LNP end-user surcharges and query services allocate the costs of those services in accordance with the principles outlined above and in its Cost Recovery Order.

Respectfully submitted,

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